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Inadequacies of the Price Freeze in a Crisis

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INADEQUACIES OF THE PRICE FREEZE IN A CRISIS

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The cease-fire in Indo-China has lifted the threat of American involvement as a belligerent in that war and perhaps in the larger war that could easily have ensued. That we were actually on the verge of such involvement is gaining increasing recognition.

This averted, much talking and some thinking are being done about the lessons to be derived from this one of a series of crises in a trigger-happy world.

One lesson, deserving but not receiving much public attention, is the obvious one that a major war is a major possibility which, if it eventuates, will require the imposition of economic controls. This is not to suggest that the problem is being officially ignored. On the contrary, the government is giving consideration to measures of control that could be utilized if the need for them should arise.

Specious Justification for the Freeze

With respect to price controls, the administration's present plan seems to be either to request stand-by authority to impose a ninety-day freeze of prices or, what is more likely, to await the development of an emergency and then propose that Congress hastily enact such a freeze. The basic justification for this plan is that it would permit the price line to be held while allowing time for careful study and enactment of legislation adequate and appropriate to the need.

Such an approach would be persuasive but for its failure to consider a very grave possibility. If we should become involved in a nuclear war, many of our productive and distributive facilities will be disrupted or wholly destroyed, water supplies contaminated, urban centers evacuated. There will be emergency need for evacuation sites and enormous supplies of water, food, clothing, beds and linens for evacuees and doctors, nurses, medicines and medical supplies for the injured. Washington itself may well be one of the first cities to be attacked. In this context of crisis and chaos it seems naive to expect a legislative body to deliberate and legislate with the objectivity and study necessary for the shaping of effective economic controls. If study, deliberation and objectivity are wanted,

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as indeed they should be, the necessary planning should be done now—when there is no crisis to supplant them with haste, confusion and expediency.

This apart, however, there are difficulties inherent in a ninety-day freeze that cast serious doubt upon it as an effective or suitable instrument.

Lack of an Administering Agency

By way of introduction, it should be recalled that in 1953 Chairman Capehart of the Senate Banking and Currency Committee introduced a bill granting stand-by authority to impose a ninety-day price freeze in an emergency. However, his bill, called the Emergency Stabilization Act of 1953, proposed the continuance on a stand-by and advisory basis of the Office of Price Stabilization. The bill was defeated and OPS was permitted to go out of existence.

With OPS gone, the Office of Defense Mobilization, which is doing some work in the field of price controls, would probably be the logical agency from which to start the formation of a price control organization. But ODM, which is charged with a great many responsibilities in addition to economic controls, has a total staff of only a few hundred. Its Stabilization Division, which is concerned not only with price controls but also with rationing, wage and rent controls, consumer credit restrictions and emergency taxes, includes but a fraction of the agency personnel.[1] In light of the fact that OPS had a peak staff of some 12,000[2] and its predecessor, the Office of Price Administration, at its height, had over 60,000 employees,[3] it must be clear that for all practical purposes there is no stand-by agency in being. And, since the Government does not plan to request authority to create one, there is none in prospect.

What we must therefore look forward to, if the need for controls should arise, is a freeze of prices without an administering

1. ODM, during the hearings on its proposed budget for fiscal 1955, requested a total staff of ten professionals and six clericals for its Stabilization Division. Even this request was actually reduced to four professionals and one clerical. *Hearings before the House Subcommittee on Appropriations, Independent Offices Appropriation Bill, 1955,* 83d Cong., 2d Session, 1182, 1261-1263 (Part 2) (1954). These figures do not include consultants serving without compensation.

2. According to the report of Price Director Tighe E. Woods to the Joint Commitee on Defense Production, dated September 17, 1952, "[b]y the end of May 1952 a peak employment of 12,129 had been reached."

3. "A Short History of OPA," p. 226.

agency.[4] This will have certain inevitable and serious consequences. These will perhaps be clearer if we first have an understanding of what the freeze legislation will provide.

In forecasting the general provisions of the freeze statute the writer makes no pretension to prophetic insight. But he was with both OPA and OPS. He played a small part in the drafting of the General Ceiling Price Regulation[5] with which OPS froze prices during the Korean War. A prodigious effort was made to avoid some of the troublesome provisions of the General Maximum Price Regulation[6] issued by OPA during World War II. But the problem proved insuperable and it turned out that the two regulations were basically and substantially the same. He believes it reasonable to assume, therefore, that the next freeze will follow the same pattern.

Freeze Provisions

It will provide that on and after a stated date it will be unlawful for anyone to offer or sell any commodity or service at a price above that at which he sold it during a specified base period. For items offered for sale but not actually sold during the base period the ceilings will be the prices at which they were offered. Since new commodities and variations of old ones are constantly being produced, the ceilings on these will be the same as the ceilings on similar items sold during the base period. If the seller had no similar item he will be permitted to determine his ceilings either by adding to his cost the mark-up on commodities having similar costs or by taking the ceilings of his closest competitor. Those who go into business after the freeze date will be permitted to select one or more competitors whose ceilings they will take as their own. Purchasers of commodities or services for use in their businesses or for resale will be forbidden to offer or pay above-ceiling prices.

Even with a fully staffed agency to administer it such a freeze would present a host of complex and difficult problems. Without such an agency the difficulties will be so numerous and troublesome as to impair and perhaps even destroy the effectiveness of the control.[7]

4. See Durham and Caplan, *Stabilization Planning Under the National Security Act*, 19 Law & Contemp. Prob. 477 (1954).
5. 16 Fed. Reg. 808 (1951).
6. 7 Fed. Reg. 3153 (1942).
7. It is noteworthy in this connection that in late 1950, notwithstanding mounting inflation, Economic Stabilization Director Valentine opposed the imposition of price and wage controls on the ground, among others, that his staff was far too small to cope with all the problems that would inevitably arise. He resigned and Michael Di Salle, newly appointed Director of Price Stabilization, issued the freeze regulation despite the serious handicaps.

And unless there is a stand-by agency existing in advance of the freeze there will be no functioning agency during its three-month existence. For if authorization for the creation of the agency is to be concurrent with enactment of the freeze legislation, the three months will be consumed in the process of organization. It will be necessary to procure and furnish quarters for national, regional and district offices; to recruit large numbers of economists, business specialists, lawyers, accountants and other trained technicians; to assemble and analyze vast quantities of economic and other data; and to draft a chart of organization, procedural regulations and standard practice instructions for personnel. This, of course, is to say nothing of the delays that will be entailed in personnel security clearances.

Until at least a basic organizational core will have been created it will be as if no agency existed. Actually it will be worse, for the job of organization will be delayed by complaints, requests for information and advice, and visits from businessmen, lawyers, accountants and trade associations seeking relief from unnecessary distortions, hardships and inequities. These, together with public criticisms that will inevitably follow, will consume the precious time of agency personnel who, in any event, will be unable to do more than plead for patience until the agency is sufficiently organized to cope with these and other problems. Meanwhile the problems will grow in number and urgency.

Unavailability of Official Interpretations

There will be, to begin with, the need for interpretations. Control agencies in the past have had interpretation divisions which, in response to requests from within and without the agencies, gave their official views of the meaning of statutory and regulatory provisions. OPA and OPS issued thousands of interpretations. These were of great value to businessmen who wished to comply fully with what was required of them but understandably preferred not to subject themselves to unnecessary limitations. The inability to obtain official interpretations will create many difficulties and result in numerous involuntary violations while, at the same time, serving as an excuse for equally numerous deliberate ones.

It is not feasible here to list more than the following few samples to illustrate the range and variety of questions that will be asked.

A merchant who had a clearance sale throughout the base period, selling many items below cost, will want to know whether these sale prices will now be his ceiling prices.

A manufacturer or retailer of a two-piece suit, identical, except for the lack of a vest, with a three piece suit sold in the base period will ask whether these are to be considered the same suits and whether the base period price of the one is the appropriate ceiling of the other.

An auctioneer who sells commodities to the highest bidders will inquire whether his sales are subject to the freeze and, if so, how he is to determine his ceilings.

A manufacturer, having several classes of purchasers to whom he sells under long term contracts, will present the following problem. During the base period he announced a general price increase. His contract with company *A,* his largest purchaser, having expired, he entered into a new contract and made sales during the base period at the increased price. His contracts with purchasers of other classes, however, expired after the base period. Consequently, his sales to these customers during the base period were at prices lower than those he charged *A.* His question will be whether his ceiling for sales to *A* will be higher than his ceilings for his other classes of purchasers notwithstanding that customarily the reverse was true.

The answers to some of the questions will be fairly clear from a reading of the statute. Yet these answers in some cases will work such hardship and, at least to some businessmen, will appear to be so absurd as to justify the belief that a contrary result must have been intended. Unable to obtain an official interpretation, many businessmen will have to make their own determinations and run the risk of the severe penalties of the law if they should decide wrongly.

The unavailability of interpretations will thus be extremely troublesome. But what will be felt at least as keenly will be the inability to obtain adjustments.

Inability to Obtain Adjustments

The seller who sold at clearance prices during the base period will face three months of business at a loss. If these months happen to be his best season he may show a loss for the entire year.

Similar will be the situation of the merchant whose supplier raised his prices so close to the end of the base period that the merchant could not put into effect a compensating increase of his own.

Their prospect will be indeed a gloomy one. Nor will it be brightened by the appearance of a new competitor, perhaps only a few doors away, selling the same commodities at substantially higher ceilings than theirs would normally have been. As a new seller he will be able to take the ceilings of competitors of his own selection.

The manufacturer whose pricing patterns for different classes of purchasers is disrupted, as well as other sellers subjected to similar distortions of prices[8] and normal business practices, will be understandably irritated and upset over his inability to obtain an adjustment in the interests of what many will undoubtedly regard as simple justice and good sense.

Absence of Enforcement

Such disruptions and irritations will lead to violations of both the innocent and wilful kind. And there will be no real enforcement during the ninety days of the freeze. Price control enforcement requires technical knowledge and training. To ferret out and prove violations generally calls for skillful analysis of business records. It will take at least the better part of ninety days to recruit and properly train investigators and other enforcement personnel and to formulate needed programs. Meanwhile, other enforcement agencies, like the FBI, will be reluctant to assume the burden of price control enforcement since it will involve a program of special training for a job that will last only until the new price control agency is ready to take over.

The initial enforcement efforts should be directed, as they have been in the past, more to achieving compliance than to punishing offenders. At the outset investigators should be seeking and correcting violations that stem from inadequate understanding of what is required. In most cases the businessmen involved will comply with the requirements when they are told how to do so. With this kind of beginning the innocent violators, in the main, are brought into compliance and enforcement efforts can then be concentrated on the wilful ones. But in the case of the contemplated freeze, violations, both innocent and wilful, will go unapprehended and uncorrected for months. Many of these will be discovered only after the freeze will have been replaced by a new price control statute. By then it will be too late to bring the offender into compliance with the superseded law and there will be no alternative but to prosecute the innocent with the wilful violator.

8. A case in which the distortion of customary price relationships was the basis for an unsuccessful attack on the validity of OPA's General Maximum Price Regulation is *Wells Lamont Corporation v. Bowles*, 149 F. 2d 364 (Em. Ct. App. 1945).

Resultant Widespread Violations

The three elements thus far discussed, unavailability of official interpretations, inability to obtain relief from price squeezes, inequities and disruptions of normal business practices and lack of enforcement, will present a serious menace to the control program. Against the background of this troublesome trinity the temptations and pressures to violate will multiply. As violations are seen to be committed with impunity other violations will be committed. And the businessman who, for example, is forced to violate the law by paying above-ceiling prices in order to procure needed stock, will be sorely tempted to charge above-ceiling prices in order to maintain his profits.

Evasions

In addition to such direct flouting of the law the more subtle evasions will also flourish. The new jobbers will appear upon the scene and many merchants and manufacturers will find it impossible to supply their needs except through these jobbers.

This, of course, is not intended to disparage legitimate jobbing which, in many industries and trades, is an established and accepted conduit in the system of distribution. The legitimate jobber stocks merchandise, accepts smaller orders than the manufacturer cares to handle, extends credit to small purchasers and performs many other useful functions.

But the jobbers who are spawned only by economic controls do none of these things. They have connections with sources of supply, and the goods they order are shipped directly from their suppliers to their customers. Their only function is to add a further mark-up to the cost of goods.

A variant of the jobber will be the finder. Ostensibly, he will locate sources of supply of hard-to-get commodities and disclose these sources for a fee. Actually, he too will have connections who will sell to new customers only with his approval.

There will be other kinds of evasions. Some meat wholesalers will abandon the settled practice of selling grocers large wholesale cuts to be carved by the latter into retail cuts for consumers. These wholesalers will now sell the grocer only retail cuts and thereby obtain prices higher than their wholesale ceilings. And sellers in other industries will require purchasers of carload lots to break down their orders into less than carload lots so that the price will be higher than the carload ceiling.

These and many other evasions and violations will be contrived. And little or nothing will be able to be done to limit these practices for the duration of the freeze.

It is not intended to suggest, of course, that evasions and violations would not occur if there were an operating agency using alternative control techniques in place of the freeze. But the difference in that case would be the existence of an active enforcement staff to apprehend and prosecute offenders and the ability of the agency to watch for evasions and amend the regulations to make them illegal. The chronic violators would continue to operate without regard to regulatory limitations until they were caught. But these are a relatively small group. For the rest of the business community there would not be, as it is almost certain there will be under the freeze, an atmosphere of uncontrolled and unpunished indifference to the law, an atmosphere that in turn would foster and encourage further violations.

Disappearance of Low Priced Commodities

Finally, apart from evasions and outright violations, there will be the completely legitimate but nonetheless highly inflationary movement into higher price lines. This is an almost inevitable consequence of shortages. In a sellers' market a manufacturer generally has no trouble selling all the commodities he can produce. His problem is that his output is limited by a scarcity of material, labor and working space. In this situation he can increase his profit by turning out a more expensive product, even though he does not increase his customary percentage mark-up. Thus, if he cannot increase his volume of 100,000 items a year on which his unit cost has been three dollars and his selling price four, he will double his profit by moving into the eight dollar price line and raising his unit profit from one to two dollars.

As a result, low priced items will tend to disappear from the market. Restaurants will change their menus and serve more costly meals. Manufacturers of inexpensive clothing, shoes, furniture, linens and a great variety of other commodities will be replacing their old lines with new and more expensive ones. In many instances, perhaps even in most, the higher priced item will have a higher production cost than the article it replaced and, in that sense, the consumer will be receiving value for what he pays. But, in clothing, as well as many other commodities, durability is not necessarily a significant factor in determining relative costs. A cheap suit or dress will often last as long as, and often outlast, more expensive garments. The cost differential is frequently accounted for by factors of style and workmanship. Consequently, it will be small comfort to the small wage earner, who is accustomed to paying thirty dollars for a suit, to know that the forty dollar suit, which he will be unable to afford, will be worth the money.

The disappearance of low priced goods will bear most heavily on the large economic group that is least capable of carrying the burden. To devise a remedy would present an enormous challenge to the most skillful and ingenious of administrative staffs. Under a freeze the problem will simply be incapable of solution.

Notwithstanding this gloomy picture, a ninety-day freeze will admittedly have some effect as a brake on inflation. It is, however, not an effective brake for a period as long as three months. In less than that time the difficulties here discussed, as well as others, will have loosened the brake. And the great danger will be that widespread disapproval and cynicism will result and that price controls will become so discredited as to make it extremely difficult, if not wholly impossible, to have an effective program after the freeze.

The most, therefore, that can be said for the proposed freeze is that it is perhaps better than nothing. But nothing is not and should not be the alternative.

Two Alternatives

A stand-by agency, doing the necessary preliminary work and preparing separate regulations adapted to the needs and practices of the separate industries would obviate most of the difficulties noted here.

And, if the political climate makes impossible the authorization of a stand-by agency, the business community, which stands to be especially hard hit by the disruptions, distortions and inequities of the freeze, could make a mighty contribution to the solution of the problem. Each trade and industry could draft an effective regulation, geared to its own settled customs and ways of doing business, and submit the regulation to the Government for approval and use when needed.[9]

Either of these proposals would make for better, more equitable, more effective control than the contemplated freeze.

For the kind of emergency we may have to face, better than nothing simply is not good enough. Elementary prudence dictates that, if the crisis should come, we must be prepared to meet it with the most effective measures of which we are capable. The ninety-day freeze does not meet that test.

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9. For a fuller discussion of both these proposals, see Convisser, *Economic Preparedness: The Problem of Price Controls,* Va. Quarterly Rev., Autumn, 1954.